ALASKA STATE LEGISLATURE
LEGISLATIVE BUDGET AND AUDIT COMMITTEE
Division of Legislative Audit

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SUMMARY OF: A Special Report on the Office of the Governor, Office of Management and Budget, 1996 Retirement Incentive Program Final Summary Schedules, for the Department of Administration, Information Technology Group, and the University of Alaska, January 15, 2001.

<u>PURPOSE OF THE REPORT</u>

In accordance with Title 24 of the Alaska Statutes and a special request by the Legislative Budget and Audit Committee, we have conducted an audit of the 1996 Retirement Incentive Program (RIP) Final Summary Schedules, dated January 15, 2001 issued by the Office of the Governor, Office of Management and Budget (OMB), for the Department of Administration (DOA), Information Technology Group (ITG) and the University of Alaska (UA).

The purposes of this audit were to:

- Determine if the net savings reported as of January 15, 2001, by OMB to the legislature, presents fairly the results of the retirement incentive programs utilized by ITG and UA, in conformity with the retirement incentive program legislation and the underlying policies and procedures.

- Determine whether OMB, ITG and UA complied with the applicable laws, regulations, and mandated procedures in its use of RIP. Specifically, we were asked to review changes, reclassifications, and inequities in the eligibility determination process.

<u>REPORT CONCLUSIONS</u>

The Office of the Governor, Office of Management and Budget, overstated the 1996 Retirement Incentive Program savings for the Department of Administration, Information Technology Group, by $423,000 and the University of Alaska by a significant but indeterminable amount. These overstatements were due to the erroneous inclusion of vacancy savings and exclusion of rehires. In other respects, OMB, DOA, and UA generally complied with the laws and rules governing this program.

Department of Administration, Information Technology Group:

<u>Savings overstated primarily by inclusion of vacancy savings</u>

OMB's misstatement of ITG savings was made up of several errors, with an erroneous inclusion of vacancy savings representing $326,000 of the $423,000.

OMB was responsible for adopting the program's policies and procedures. OMB specifically prohibited the inclusion of vacancy savings, but it did allow the savings from position eliminations to be counted. That is, OMB decided that temporary vacancies were a normal result of employee turnover and should not be considered part of RIP savings. However, long-term position eliminations were to be counted as RIP savings.

ITG had estimated a net savings from RIP of $875,000. However, when the staff of DOA, Division of Administrative Services, compiled the data to be submitted to OMB, it estimated $1,201,000. The $326,000 increase was largely due to inclusion of vacancy savings from positions remaining vacant rather than being filled. DOA's Administrative Services erred by including vacancy savings and OMB erred by failing to remove them. In its January 15, 2001 report to the legislature, OMB erroneously stated that vacancy savings had been excluded.

University of Alaska:

<u>Savings overstated by ignoring rehires</u>

UA rehired approximately 140 RIP participants after they retired. OMB instructed agencies to include the cost of replacement employees in the calculations. Had UA included the cost of these rehires, the savings presented would have been substantially less. However, how much less was not reasonably determinable by audit procedures, either by full examination or through sampling. Typically, there was a savings because these RIP participants only worked part-time or part of the year up to 49% of their previous salary and UA only paid into Social Security. That is, UA was no longer responsible for their health insurance and retirement costs.

December 2, 2002

Members of the Legislative Budget
and Audit Committee:

In accordance with the provisions of Title 24 of the Alaska Statutes, the attached report is submitted for your review.

OFFICE OF THE GOVERNOR
OFFICE OF MANAGEMENT AND BUDGET

1996 RETIREMENT INCENTIVE PROGRAM
FOR
DEPARTMENT OF ADMINISTRATION
INFORMATION TECHNOLOGY GROUP
AND
UNIVERSITY OF ALASKA

January 15, 2001

Audit Control Number

02-30001-03

The purpose of our audit was primarily to determine whether the Office of the Governor, Office of Management and Budget, Department of Administration, Information Technology Group, and the University of Alaska, fairly stated the 1996 Retirement Incentive Program, Final Summary Schedules dated January 15, 2001, in accordance with the program legislation and the underlying policies and procedures.

The audit was conducted in accordance with generally accepted government auditing standards. Fieldwork procedures utilized in the course of developing the findings and discussion presented in this report are discussed in the Objectives, Scope, and Methodology section. Audit results are found in the Report Conclusions, Independent Auditor's Report, and Final Summary Schedules.

Pat Davidson, CPA
Legislative Auditor

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OBJECTIVES, SCOPE, AND METHODOLOGY

In accordance with a Legislative Budget and Audit Committee special request and Title 24 of the Alaska Statutes, we conducted an audit of the 1996 Retirement Incentive Program (RIP) Final Summary Schedules dated January 15, 2001, issued by the Office of the Governor (OG), Office of Management and Budget (OMB), for the Department of Administration (DOA), Information Technology Group (ITG), and the University of Alaska (UA). The objectives, scope, and methodology of our review were as follows.

Objectives

The objectives of the audit were to:

- Determine if the net savings reported as of January 15, 2001, by OMB to the legislature, presents fairly the results of the retirement incentive programs utilized by ITG and UA, in conformity with the retirement incentive program legislation and the underlying policies and procedures.

- Determine whether OMB, ITG and UA complied with the applicable laws, regulations, and mandated procedures in its use of RIP. Specifically, we were asked to review changes, reclassifications, and inequities in the eligibility determination process.

Scope and Methodology

Employees were deemed to be eligible if the calculations showed a net savings. Approximately one-half of those eligible, and offered RIP, did not wish to retire.

	UA	ITG
Eligible for RIP	784	27
Declined	(407)	(13)
RIP Participants	377	14

We reviewed the files for all 14 ITG participants.

We reviewed 42 of the 377 UA participant files. Although our sample was judgment based, it was not spread across the entire population. That is, for sampling purposes, our universe was reduced from 377 to 230. This was due to a 1997 payroll conversion that made the tracking of pre-1998 RIP participants much more difficult. Therefore, we had a scope limitation for these pre-1998 participants due to practicality.

This scope limitation had no impact on our audit of the net savings reported by UA, because our sample of 42 participants indicated the reported amounts were likely to be overstated and so we had already given the statement an adverse opinion. These practical considerations did, however, represent an audit limitation of our compliance review of this program.

Our review included the following:

- Records of RIP participants maintained by the Department of Administration, Division of Retirement and Benefits.

- Files pertaining to the participants maintained by the personnel and administrative services sections of DOA and UA.

- Information on the participants obtained from the State of Alaska and UA automated payroll systems.

- Instructions issued by OMB regarding the assumptions, procedures, and methods to be used in determining participant eligibility and calculation of individual net savings.

- Instructions issued by OMB regarding the annual reporting of net savings by agencies who offered a RIP.

- Annual reports to the legislature issued by OMB beginning January 1998 and ending with the final report in January 2001.

- Detailed schedules of individual participant's net savings from OMB supporting the summary data reported in the annual reports for DOA and UA.

- Discussions with management and staff of DOA, ITG and Division of Administrative Services, OMB, and UA.

- Results of an audit performed by DOA, Division of Retirement and Benefits, on UA's payroll system and reporting procedures relevant to PERS, TRS, and the Social Security Administration.

- Legislative committee minutes pertaining to the 1996 RIP.

ORGANIZATION AND FUNCTION

In 1996 the Legislature authorized[1] a retirement incentive program (RIP) for State employees and the employees of various local governments. The introduction to the legislation was as follows:

> *The State of Alaska and many local governments are facing the need to restructure their operations and their work forces in order to reduce expenditures and to balance budgets. Retirement incentives are management tools that have been used extensively by the private sector, the federal government, and other state and local governments across the country. . . . This Act will enable these entities to be more efficient and cost-effective by eliminating certain nonessential positions and producing a net reduction in personnel costs.*

Under the legislation, an employer who adopted a plan under RIP could designate categories of employees eligible to participate in that plan.

> *An employer need not extend the incentive plan to all employees who would otherwise be eligible, but may choose to extend the plan only to employees*
>
> *(1) in specific budget or administrative components of the employer;*
> *(2) in specific job classifications;*
> *(3) in specific geographic locations; or*
> *(4) on the basis of any combination of factors under (1) – (3).*

An employee was eligible to participate in a retirement incentive plan only if the employee was a vested member of the public employees' retirement system or the teachers' retirement system and, with the additional RIP credit of three years service, would be qualified to retire under one of those systems. In addition, accumulated savings to the employer in personal services costs had to exceed the total cost to the employer spread over the three years from the employee's retirement date. This period was referred to as the "three-year savings period."

Each State agency had to submit a detailed plan to the Office of the Governor, Office of Management and Budget (OMB), describing the effect on the agency's personal services costs and operations. This plan, along with its financial information, had to be approved by OMB before it could be approved by the commissioner of administration.

[1] Chapter 4, FSSLA 1996.

The head of OMB testified in legislative hearings[2] that

> *[My] office intends to very tightly scrutinize the proposals because [these agencies] need the cost savings. They cannot afford to be inaccurate on projections . . . . [My] office will review proposals both from a budget analyst side and from a policy and organizational side to be sure both are achievable.*

OMB was required to report RIP information annually to the legislature, beginning January 1998 and ending January 2001. These reports were to include, among other things, the number of positions affected by the RIP and a schedule showing actual savings for years past and projected amounts for the remainder of the three-year period.

[2] House State Affairs Standing Committee minutes, April 1, 1995.

REPORT CONCLUSIONS

The Office of the Governor, Office of Management and Budget (OMB), overstated the 1996 Retirement Incentive Program (RIP) savings for the Department of Administration (DOA), Information Technology Group (ITG), by $423,000 and the University of Alaska (UA) by a significant but indeterminable amount. These overstatements were due to the erroneous inclusion of vacancy savings and exclusion of rehires. In other respects, OMB, DOA, and UA generally complied with the laws and rules governing this program. Our findings are outlined below.

Department of Administration, Information Technology Group:

Adverse opinion on financial schedule

As discussed in the Independent Auditor's Report, the $1,201,000 in Retirement Incentive Program savings reported by the Office of the Governor, Office of Management and Budget, on its Final Summary Schedule for ITG were overstated by approximately $423,000, or 35% of the reported amount. Given the magnitude of this misstatement, we issued an adverse opinion on this schedule.

Savings overstated primarily by inclusion of vacancy savings

OMB's misstatement of ITG savings was made up of several errors, with an erroneous inclusion of vacancy savings representing $326,000 of the $423,000.

As discussed in the Notes to the Final Summary Schedules, OMB was responsible for adopting the program's policies and procedures. OMB specifically prohibited the inclusion of vacancy savings, but it did allow the savings from position eliminations to be counted. That is, OMB decided that temporary vacancies were a normal result of employee turnover and should not be considered part of RIP savings. However, long-term position eliminations were to be counted as RIP savings.

ITG had estimated a net savings from RIP of $875,000. However, when the staff of DOA, Division of Administrative Services, compiled the data to be submitted to OMB, it estimated $1,201,000. The $326,000 increase was largely due to inclusion of vacancy savings from positions remaining vacant rather than being filled. DOA's Administrative Services erred by including vacancy savings and OMB erred by failing to remove them. In its January 15, 2001 report to the legislature, OMB erroneously stated that vacancy savings had been excluded.

University of Alaska:

<u>Adverse opinion on financial schedule</u>

As discussed in the Independent Auditor's Report, the $17.8 million in RIP savings reported by OMB on its Final Summary Schedule for UA were significantly overstated. Although the amount of the overstatement was not determinable, we nevertheless concluded that, given its probable magnitude, an adverse opinion on this schedule was appropriate.

<u>Savings overstated by ignoring rehires</u>

UA rehired approximately 140 RIP participants[3] after they retired. OMB instructed agencies to include the cost of replacement employees in the calculations. Had UA included the cost of these rehires, the savings presented would have been substantially less. However, how much less was not reasonably determinable by audit procedures, either by full examination or through sampling.[4] Typically, there was a savings because these RIP participants only worked part-time or part of the year up to 49% of their previous salary and UA only paid into Social Security. That is, UA was no longer responsible for their health insurance and retirement costs.

<u>Laws and other program rules broken in only a few instances</u>

Except for the rehire rule discussed above, UA generally complied with the laws and rules governing this program. However, we noted a few deviations in our sample, such as the following:

- A term employee working on a capital project was allowed to retire under this program. This position would have terminated at the end of the project. Applying this methodology, this employee did not qualify[5] for retirement. There was a $30,000 net cost to the State, not a savings.

- A position was "deleted" in one department and used to justify a RIP retirement. However, the position was merely transferred to another department.

- A position was downgraded and a low step within the salary range was selected in order to show a RIP savings. However, the replacement came in at a much higher step. UA recognized the error, but determined that it was too late to correct it.

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[3] This count was obtained from a review done by the Department of Administration, Division of Retirement and Benefits.

[4] Full examination of the entire population of RIP retirees, or even only those who were rehired, would have been a long and expensive process at this late date. A sampling approach would also not have been a very efficient approach due to the population's high standard deviation, thus requiring a large sample size. Further, based upon our internal control review and our initial sample, we believe our Independent Auditor's Report would still have been adverse, regardless of how much audit work was done in this area.

[5] Section 22(b)(3), Chapter 4, FSSLA 1996.

Independent Auditor's Report

Members of the Legislative Budget
and Audit Committee:

We have audited the accompanying Final Summary Schedules of the 1996 Retirement Incentive Program, Office of the Governor, Office of Management and Budget, for the Department of Administration, Information Technology Group, and the University of Alaska, dated January 15, 2001 according to the terms of the 1996 Retirement Incentive Program legislation and underlying policies and procedures. These schedules are the responsibility of the Office of the Governor, the Department of Administration, and the University of Alaska. Our responsibility is to express an opinion on these financial schedules based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform audits to obtain reasonable assurance about whether the financial schedules are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the summary schedule. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as the overall financial schedule presentation. We believe our audit provides a reasonable basis for our opinion.

As described in the Notes to the Final Summary Schedules, the Office of Management and Budget (OMB) adopted policies, procedures, and assumptions to be used for this program. This presentation was not intended to be in accordance with generally accepted accounting principles.

One of the more significant policies was that it required agencies to show a net savings for each retiring employee without inclusion of any vacancy savings. These are the personal services costs "saved" by not immediately filling a vacated position.

As described in the Notes to the Final Summary Schedules, OMB interpreted the legislation to require agencies to update their summary schedules to show actual savings to date and forecasts for the remaining years. Thus, the January 15, 2001 schedule was to show actual savings amounts for FY 97 through FY 00 and estimated amounts for FY 01 through FY 03.

Also described in the Notes to the Final Summary Schedules, OMB required agencies to reduce an individual's estimated savings by the expected position costs of the replacement employee.

Because of departures from the policies and procedures established by OMB, the savings presented for the University of Alaska Retirement Incentive Program in its January 15, 2001 Final Summary Schedule were materially overstated. This was primarily due to the misstatement of replacement employee costs. However, the amount of the savings overstatement is not reasonably determinable.

Because of departures from the policies and procedures established by OMB, the amount reported as net savings for the Information Technology Group Retirement Incentive Program was overstated by $423,000 (35%). This was primarily due to the inclusion of vacancy savings in the schedule. These amounts were included even though OMB instructed state agencies to include only the savings from deleted or downgraded positions in justifying an individual employee's qualifying retirement. In the text that accompanied the January 15, 2001 Final Summary Schedule, the OMB erroneously stated that vacancy savings had been excluded.

In our opinion, because of the effects of the matters discussed in the preceding paragraphs, the Final Summary Schedules referred to above do not present fairly, in conformity with the Retirement Incentive Program legislation and the underlying policies and procedures, the results of the University of Alaska and Information Technology Group's 1996 Retirement Incentive Programs.

In accordance with Government Auditing Standards, we have also issued our report dated November 15, 20012on our tests of compliance with certain provisions of laws and policies and on our consideration of the State of Alaska's internal control over financial reporting.

Pat Davidson, CPA
Legislative Auditor

November 15, 2002

Independent Auditor's Report on Compliance and on Internal Control Over Financial Reporting of the Final Summary Schedules Performed In Accordance with *Government Auditing Standards*

Members of the Legislative Budget
and Audit Committee:

We have audited the Final Summary Schedules of the 1996 Retirement Incentive Program, Office of the Governor, Office of Management and Budget, for the Department of Administration, Information Technology Group, and the University of Alaska, dated January 15, 2001, according to the terms of the 1996 Retirement Incentive Program legislation and underlying policies and procedures. We have issued our report on the schedules dated November 15, 2002. The report contains an adverse opinion because the amounts reported are materially overstated. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether the schedules referred to in the preceding paragraph are free of material misstatement, we performed tests of the agencies' compliance with certain provisions of laws, regulations and policies, noncompliance with which could have a direct and material effect on the determination of amounts reported in the schedules. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance that are required to be reported under *Government Auditing Standards* and are described in the Report Conclusions section of this report.

Internal Control Reporting

In planning and performing our audit, we considered the agencies' internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the schedules identified above and not to provide assurance on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the agencies ability to record, process, summarize and report financial data consistent with the assertions of management in the Final Summary Schedules. Reportable conditions are described in the Report Conclusions section of this report.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce, to a relatively low level, the risk that misstatements in amounts that would be material, in relation to the Final Summary Schedules being audited, may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe the reportable conditions discussed in the Report Conclusions section of this report are material weaknesses.

This report is intended for the information of the State's management and members of the Alaska Legislature. However, this report is a matter of public record and its distribution is not limited.

Pat Davidson, CPA
Legislative Auditor

November 15, 2002

Office of the Governor
Office of Management and Budget
1996 Retirement Incentive Program
Final Summary Schedules
for
Department of Administration
Information Technology Group (ITG)
and
University of Alaska (UA)
January 15, 2001

		ITG	UA
Number of Employees Retired under RIP		14	377
Number of Positions Deleted		3	279
Number of Positions Reclassified		2	Not Available
Net Savings by Fiscal Year:			
FY 97	Actual	$ - 0 -	$ - 0 -
FY 98	Actual	432,000	2,466,000
FY 99	Actual	423,000	4,236,000
FY 00	Actual	261,000	5,971,000
FY 01	Estimated	80,000	3,479,000
FY 02	Estimated	4,000	1,627,000
FY 03	Estimated	1,000	- 0 -
		$1,201,000	$17,779,000

Dollar amounts are rounded to the nearest thousand.

The amounts shown in the schedule for ITG were appropriately combined with other Department of Administration divisions and reported in total for the department in its January 15, 2001 Final Summary Schedule.

The accompanying notes are an integral part of these financial schedules.

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Office of Governor
Office of Management and Budget
1996 Retirement Incentive Program
Notes to the Final Summary Schedules
for
Department of Administration
Information Technology Group
and
University of Alaska
January 15, 2001

The purpose of the Retirement Incentive Program[6] (RIP) was to provide an incentive for employees to retire earlier so their positions could be deleted, downgraded through reorganization of operations, or filled with less expensive employees. The program was to provide agencies with a management tool to help meet budget pressures by reducing personal service costs and to help avoid layoffs that would otherwise be necessary due to budget cuts. It was to enable the agencies to be more efficient and cost-effective by eliminating certain nonessential positions and producing a net reduction in personnel costs.

The State of Alaska's most recent RIP began June 1996 and ended January 2000. Under this program, agencies were authorized to adopt RIP plans at any time beginning June 1996 and continuing through June 1999 with the requirement that participating employees retire no later than January 2000. Under this retirement program, the Office of the Governor, Office of Management and Budget (OMB), was required to report the costs and savings attributable to this program to the legislature. In order to gather this data in a consistent and meaningful manner, OMB adopted the following policies, procedures, and assumptions:

- The total salary and benefit costs of each RIP participant were compared over a three-year period to the expected position costs of the replacement employee, unless the position was deleted.

- The replacement employee's salary was assumed to start at the second pay step of the related salary range, rather than the initial step.

- Vacancy savings[7] were not included because such savings were deemed to be a normal part of employee turnover and, if included, these savings would have overstated the savings from RIP.

- Net savings were calculated by deducting the employer RIP costs, which were the amounts paid into the retirement system for the additional costs related to RIP, and a small administrative fee from the position savings.
- The calculations assumed that none of the employees who retired under RIP would have retired at that time if RIP was not available.

[6] Chapter 4, FSSLA 1996.
[7] These are the personal services costs "saved" by not immediately filling a vacated position.

- The calculations did not include the long-term savings that should result from replacing employees in the Tier I and Tier II retirement categories with Tier III employees.[8]

- The calculations did not include the "ripple effects" of additional savings from vacancies created by promotions and transfers into RIP positions vacated by the retirees.

- Agencies, including the University of Alaska, were to update the calculations each year with actual savings achieved to-date and with revised estimates for the remaining years. The January 15, 2001 final summary schedule was to include actual savings for FY 97 through FY 00 and estimates for FY 01 and FY 03.

The assumptions in the above list were necessary, as a practical matter, to allow the RIP to occur. It cannot be known if this employee or that one might have elected to retire, absent RIP. To the extent that some of these employees were going to retire anyway, these calculations overstated the savings. However, as noted above, the calculations did not include the Tier III replacements or the "ripple effects" of replacements. Excluding these understated the savings. However, it would have been similarly impractical to calculate them.

[8] Public Employees' Retirement System has reduced the benefits, and hence the costs, for those employees hired after June 1986. Employees hired after June 1986, but before July 1996, are referred to as Tier II employees, while those hired July 1996 or after are referred to as Tier III employees. Benefit costs for Tier III employees are less than for Tier I or Tier II employees and benefits costs for Tier II employees are less than for Tier I employees. These differences are due to changes enacted by the legislature.

December 27, 2002

Pat Davidson, Legislative Auditor
Division of Legislative Audit
P.O. Box 113300
Juneau, AK 99811-3300

Dear Ms. Davidson:

This letter is in response to the preliminary audit on the retirement incentive program (Audit #02-30001-03). As you know, this program ended under the prior Administration. I have reviewed the preliminary audit, as well as the response to the Legislative Audit management letter on this issue that was prepared by the former OMB director, and have no additional comments.

Sincerely,

Cheryl Frasca
Director

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STATE OF ALASKA

OFFICE OF THE GOVERNOR

OFFICE OF MANAGEMENT AND BUDGET

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DEC - 5 2002

November 29, 2002

Danna Moser
Division of Legislative Audit
3305 Arctic Blvd., Suite 101
Anchorage, AK 99503

Dear Ms. Moser:

This letter is in response to management letter No.1 of November 20, 2002, regarding the retirement incentive program (RIP). Your letter raised concerns about the RIP savings estimates in OMB's final RIP status report for the Information Technology Group (ITG) in the Department of Administration (DOA) and for the University of Alaska (UA).

The management letter noted that DOA erroneously included position vacancy savings in their ITG savings estimate, and that the correct ITG savings estimate should be $778,000, rather than $1,201,000. I agree that vacancy savings should not have been included, and we have revised our records to reflect the corrected ITG savings estimate. Even with that correction, the savings was nearly a million dollars so obviously it would not have changed our decision to approve the division's RIP plan.

Regarding the University of Alaska, the management letter noted several concerns. The primary concern was that UA overstated RIP savings because their estimates did not account for the rehire of approximately 140 RIP participants under contract. The management letter also noted concerns about four individual positions included in the UA RIP.

The letter states "OMB instructed agencies to include the cost of replacement employees in the calculations. Had UA included the cost of these rehires, the savings presented would have been substantially less." The UA RIP savings estimates provided to OMB when plan approval was requested and again when the annual report was prepared show that UA did include the cost of replacement employees for most of the positions included in the RIP.

The University can address this issue in more detail in their management letter response, as they can provide a more complete explanation of the methodology used to prepare their RIP savings estimates. I would like to note, however, that the University's estimate of total RIP savings was over $17 million. Clearly, the RIP program resulted in substantial savings for the University, regardless of the exact amount of savings. I think it would be a waste of time and money for the

University to go back through their RIP records position by position to verify their RIP savings estimates. Your own management letter states: "Full examination of the entire population of RIP retirees, or even only those who were rehired, would have been a long and expensive process at this late date."

Regarding your concerns about the four individual positions included in the UA RIP, the University is researching the details of these four positions and will respond to the concerns raised. However, I would like to comment on the concerns raised about two of the positions.

The management letter states that one of the employees allowed to participate in the UA RIP was a term employee working on a capital project. If in fact this position would have terminated shortly at the end of the capital project, I agree that this employee should not have qualified for the RIP. However, state agencies and the University routinely fund ongoing, permanent positions with CIP receipts; these positions were eligible for the RIP. If the UA position in question falls into this category, it was eligible for the RIP, provided the other requirements were met.

The letter also states that a position was downgraded and a low step within the salary range was selected in order to show a RIP savings, but that the position was refilled at a higher step. The letter notes that UA recognized the error, but determined that it was too late to correct it.

Based on this information, it does not appear that any error was made in this case. Under the RIP guidelines, OMB did not require state agencies or the University to refill positions at the salary step used in the RIP savings calculations. This policy reflected the fact that it was usually impossible to predict who would be hired to refill RIP positions, and that in some cases, the positions would be filled through internal promotions or transfers that may require a higher salary step than a new state employee would. We did require that the RIP savings calculations be based on refilling positions at a "B" step to account for the fact that not all positions would be refilled at an "A" step. In cases where the new person came in at an A step, there would be more savings than the estimate indicated, offsetting cases where the replacement was at a step C or above.

If you have any questions or would like to discuss these issues further, please contact Jack Kreinheder at 465-4676.

Sincerely,

Annalee McConnell

Annalee McConnell
Director

January 7, 2003

Pat Davidson
Legislative Auditor
Division of Legislative Audit
P.O. Box 113300
Juneau, AK 99811-3300

Re: Preliminary Audit report on the Retirement Incentive Program (RIP) for Department of Administration Information Technology Group (ITG) and University of Alaska, January 15, 2001

Dear Ms. Davidson:

Thank you for the opportunity to respond to the above referenced audit.

The Department of Administration concurs that the ITG RIP savings report submitted to the Office of Management and Budget (OMB) failed to exclude vacancy savings from positions that remained vacant, as required by OMB. Although most of these positions remained vacant for an extended period of time, they were not deleted and therefore the savings should not have been reported.

According to information contained in your report, the RIP program in ITG resulted in savings of $778,000. Further as stated in the audit notes, the calculations did not include the long-term savings that should result from replacing employees in the tier I and tier II retirement categories with tier III employees, and ripple effects within ITG.

The department acknowledges the submitted report contained errors and we will revisit the internal process used to calculate the information in the report. Thank you for bringing this to our attention and allowing us to comment on the audit.

Sincerely,

Sharon Barton
Acting Commissioner

SB/DS/jd
cc: Alison Elgee, Deputy Commissioner, DOA
David Koivuniemi, Assistant Commissioner, DOA
Dan Spencer, Director, Administrative Services, DOA
Larry Walsh, Director, ITG, DOA

Mark R. Hamilton
President

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January 8, 2003

Ms. Pat Davidson, CPA
Legislative Auditor
Legislative Budget and Audit Committee
P.O. Box 113300
Juneau, Alaska 99811-3300

Dear Ms. Davidson:

This letter is in response to your December 19, 2002 request for comments on the preliminary audit report concerning the 1996 Retirement Incentive Program (RIP). I am responding to the report conclusions applicable to the University of Alaska.

The University appreciates the effort and professionalism of the work done by you and your staff. The RIP was used by the University as a management tool and evaluation of the overall effectiveness of that tool is important. I hope the following response resolves the bulk of your stated concerns such that we can agree that the University's implementation of the RIP and its reporting of cost savings were consistent with both the letter and the spirit of the retirement incentive program.

Adverse opinion on financial schedule: The university made its best effort to reflect RIP savings according to its understanding of the rules established by OMB at the time it reported the savings. The university agrees that it was difficult to calculate savings in some instances because savings could not be calculated simply by tracking what happened to a particular position number. Calculating an exact savings amount is dependent on applying standard assumptions and methodology. The RIP clearly resulted in savings to the university. I believe that the effort necessary to rework savings numbers using different criteria would outweigh any benefit received at this point in time.

Non-benefits eligible rehires: Your report states that savings were overstated because the University did not offset savings by the cost of rehiring those RIP retirees who were rehired. You apparently determined that of those rehired, a significant number were rehired to perform the same or a similar function, although not in the same position number.

If a RIP retiree were rehired to perform the same work, <u>and that work would not otherwise have been accomplished by another employee at expense to the University</u>, failing to offset savings by the cost of rehiring the employee would overstate savings. However, the second prong of that test has not been demonstrated.

The RIP was a management tool to achieve cost savings. While it limited rehires in an effort to ensure savings, it was not designed specifically to prevent rehire. In fact, the law provided that the Board of Regents could rehire employees where there was a compelling reason to do so. The University did take advantage of this opportunity, following procedures required by the law.

Your analysis seems to assume that none of the rehires performed work that was being performed or was about to be performed by someone else at the time of retirement. Rather, the University sought in many instances to capitalize on the efficiency and reduced (no benefits) cost of using experienced retirees for positions other than the position vacated, but which would have otherwise been filled. In doing so, it had the opportunity to hand pick the stars from its retirees, thereby avoiding benefits costs and minimizing retraining for tasks that were critically important to the University.

There may have been overlap with the type of work done before and after retirement. Yet, that is consistent with the statutory permission given to the university (as compared to the more limited permission given state agencies) to rehire and begs the question of whether there were savings. Nothing in the DOA guidelines either required or, from an economic analytical standpoint, should have required offsetting savings in one position by costs of rehiring a RIP retiree. Where a retiree occupies a position that would otherwise have required work by a regular employee, getting the work done by retirees actually understates savings in most cases. To the extent that it is conceivable that retirees could have been hired into positions that were not intended to be refilled, or at a cost greater than would otherwise have been required, those excess costs would likely have been offset by the overall additional savings and efficiencies achieved by rehiring RIP retirees. In the broad scheme of things, the effort to determine if this factor caused any overstatement of savings is not justified by further work that will in any event demonstrate intended cost savings.

Allowing a term employee to take advantage of the RIP: You have expressed the concern that a certain term employee who could have been non-renewed was allowed to take advantage of the RIP. While you are technically correct that the employee had at one point agreed to convert her appointment to a term for the convenience of her employer, upon a change of circumstances, she in fact continued to serve in a permanent capacity for some six years thereafter. As of December 1, 1998, however, she was considered to be a "regular" employee, which comported with the facts of her employment. If there was a mistaken reference in her records, it would not have survived challenge by the employee. To have denied the employee the opportunity to take advantage of the RIP would have been both unfair and potentially discriminatory. Consequently, the savings from her participation were properly considered, and she was entitled to retire under the program.

Rehire into the same position number: Your report states that "a position was 'deleted' in one department and used to justify a RIP in another. However, the position was merely transferred to another department." The university has a complex structure that changes over time. Two very good justifications exist for the University's approach to reporting savings for this position. First, the position within the UAA College of Business and Public Policy (COB&PP) you reference was not refilled until August 2001, well over four years after the employee retired under the program. The guidelines provided that "The total salary and benefit costs of each RIP participant were compared over a three-year period to the expected position costs of the replacement employee, unless the position was deleted." Since there were no salary and benefit costs over the entire three-year period following the retirement, there was no overstatement of savings.

Second, the position was originally in the COB&PP. When it was refilled over four years later, it was refilled in ISER, a component of the COB&PP. Thus, any "shifting" was internal to the college, and clearly did not impact the cost savings, or represent any attempt to contribute to an overstatement of savings.

Advanced placement of replacement employee: Your report also states that "A position was downgraded and a low step within the salary range was selected in order to show a RIP savings. However, the replacement came in at a much higher step." Under the RIP guidelines, the university was not required to refill positions at the salary step used in the RIP savings calculation. A good faith effort was made to ensure that each position eligible for RIP would show actual savings. However, calculations were, of necessity, projections. In an effort to ensure that projected savings overall would be accurate, step "B" was used in the calculation in order to compensate for the fact that some replacements would be hired at advanced steps rather than the lowest step (A).

Again, thank you for the opportunity to provide comment. Please contact Dave Read at 474-7710 or Randy Weaver at 474-7711 if you have questions or need to clarify anything in this response.

Sincerely,

Mark Hamilton
President

JAP/RLW/DR/

VIA FACSIMILE 907 465-2347

cc: Vice President Joe Beedle
General Counsel Jamo Parrish
Controller Randy Weaver
Acting Audit Director David Read

January 9, 2003

Members of the Legislative Budget
and Audit Committee

We have reviewed the responses to our preliminary audit on the 1996 Retirement Incentive Program (RIP), as administered by the Office of the Governor, Office of Management and Budget (OMB), for the Department of Administration (DOA), Information Technology Group, and the University of Alaska. Nothing contained in these responses gives us cause to reconsider our findings.

A change of administrations occurred during the report finalization stage. This impacted the responses from DOA and OMB. Both had responded under the prior administration to our management letter findings. In response to our preliminary report, under the new administration, DOA was able to fully respond to our findings. However, OMB elected not to make any additional comments. To provide readers a more complete understanding of the views of management, we have included OMB's response to our management letter as part of the final report and respond to it accordingly.

The Department of Administration acknowledges its errors. However, OMB and the University generally do not. We disagree with their explanations and offer the following additional comments. These comments are presented in the order discussed in the University's response to the report.

Rehires: The University excluded the cost of rehiring RIP retirees, even though these costs were required to be included by OMB rules. Further, the RIP legislation prohibited the rehiring of many of these retirees. This prohibition, in Section 30, Chapter 4, FSSLA 1996, clearly states that the University can only enter into personal services contracts with these retirees

> *. . . if the Board of Regents, for the University of Alaska . . . determines that there is a* ***compelling reason to do so because of the individual's specialized or extensive experience*** *that relates to particular program or project of the . . . university.* [Emphasis added.]

The majority of the rehires were for administrative and clerical positions. There was no case made, compelling or otherwise, documenting the individual's specialized or extensive experience. Rehire requests appeared to be rubber stamped. There were no denials in the four years of this program.

Whether an individual rehire benefited the University could certainly be debated from a cost/benefit perspective. The legislature set up the program with certain rules designed to allow employers to reduce costs and better manage their workforces. To make it work, the legislature established a generous package to entice eligible employees to retire. Rehire was to be used to benefit the agency not the employee. However, the University used rehire as an additional enticement to encourage otherwise reluctant employees to retire. Whether this was the best move for the University could be debated at length. However, what is clear is that these rehires were contrary to statutory intent and the resulting costs should have been included as a reduction to the RIP savings reported to the legislature.

Allowing a term employee to take advantage of RIP: The University contends that the employee had been a term employee many years earlier and had since become a permanent employee of the University. It goes on to state that it *"would have been both unfair and potentially discriminatory"* to have denied this employee the opportunity to participate in RIP.

Our conclusion that this employee was ineligible under the RIP rules was based on the University's personnel records and unemployment insurance records from the Department of Labor and Workforce Development. The insurance records include a signed statement from the University stating that it did not have work for this individual. Further, the University's own records show that the job ended and the RIP employee's replacement had to change jobs after only six weeks. Therefore, we appropriately concluded that this RIP employee was a term employee and should not have been allowed to retire under this program. OMB states its agreement with our opinion that in cases where the position terminates the individual would not have qualified for RIP.

Rehire into the same position number: In this case, the University attempts to deflect attention to the problem by saying that its structure is complex and changes over time. While the University's statements may be correct from an internal department to department perspective, it is not accurate for the University as a whole. The position in question was supposedly "deleted" for the three-year savings period and this deleted cost was used to justify the RIP retirement. In fact, the position continued to be fully funded through the state budget process. Therefore, no RIP savings should have been reported for the position.

Advanced placement of replacement employee: Both the University and OMB respond by saying that the University was not required to hire replacements at the salary levels used in the RIP calculations. They are correct. However, as the University is aware, there was more to this case. OMB's instructions specifically stated that salary Step B was to be used, unless it was likely to be filled at a higher or lower level. In these situations, written justification was to be provided to OMB. The position was downgraded while at the same time the job requirements were significantly increased. Therefore, the University was or should have been aware that this position would not likely be filled at the lower pay level.

The University should have provided written justification for a replacement at a higher salary level for OMB to scrutinize during the RIP plan approval process. The written justification to OMB was part of the control system designed to prevent this sort of thing. Had the justification been prepared, it would have shown to both the University and OMB that this employee did not qualify for RIP.

In summary, we reaffirm the findings and conclusions presented in the report.

Pat Davidson, CPA
Legislative Auditor